Minimum Revenue Provision post-consultation proposal

Overview

Following a consultation on proposed changes to regulations, aimed at strengthening compliance with the duty to make Minimum Revenue Provision (MRP), the government has been made aware of concerns raised by a number of authorities that the changes may have unintended consequences where authorities have made capital loans.

While the intent of the changes is to make sure that prudent MRP is made each year, as well as prevent practices that result in under-provision of MRP, the government has also been clear that it does not want to stymie sensible investment or cause undue financial pressures. We have carefully considered the sector's concerns, balanced against the government's objective of strengthening the duty to make MRP and to safeguard against practices that result in under-provision. To recognise the specific issue with respect to capital loans, we amended the proposals to provide additional flexibilities with respect to capital loans.

The government will issue a full response to the consultation in due course. The intent of this survey is to test these proposals with the sector and stakeholders to make sure that they address the specific concerns raised but do not create additional risk to either the government's objectives or to the sector. This is particularly important given the technical nature of the changes. The evidence gathered in this exercise will inform the government's final response.

Responses to this survey should be completed with regards to **Annex A – Post consultation regulation changes** which sets out the text that would be introduced into regulations (see **Related Documents Below**). Please note that the Statutory Guidance on Minimum Revenue Provision (Statutory Guidance) will be revised to reflect the changes in regulations.

Why your views matter

1. To test that the amendment addresses concerns raised with respect to making MRP on capital loans.

2. To ensure that the wording of the proposed regulation changes meets the policy intent and does not have any unintended consequences.

Introduction

1 What is your name?

Name *(Required)*

2 What is your email address?

If you enter your email address then you will automatically receive an acknowledgement email when you submit your response.

Email

3 What is your organisation?

Organisation *(Required)*

Summary

1. Following a **consultation** *<https://www.gov.uk/government/consultations/changes-to-the-capital-framework-minimum-revenue-provision/consultation-on-changes-to-the-capital-framework-minimum-revenue-provision>* on proposed changes to regulations to strengthen compliance with the duty to make Minimum Revenue Provision (MRP), the government has been made aware of concerns raised by a number of authorities that the changes may have unintended consequences where authorities have made capital loans. Specifically, that the amendments as originally proposed would require authorities to make MRP where they have made a capital loan which is financed by debt. Where authorities are not currently making MRP with respect to debt used to make capital loans, this would increase the cost and potentially make some schemes unaffordable; housing delivery was a commonly raised example of activity that would be affected.

2. While the intent of the changes is to make sure that prudent MRP is made each year and to prevent practices that result in under-provision of the provision, the government has also been clear that it does not want to stymie sensible investment or cause undue financial pressures. With respect to risk, the rationale put forward from the sector is that risks associated with capital loans is one of credit risk (that the authority may not receive repayment for part or all of the loan). Further, that repayment of loans to an authority represents cash that is ultimately set aside and available for the repayment of the council's own debt liability. Therefore, it should not be *necessary* to make MRP provided the loan is being/will be repaid.

3. We have carefully considered the sector's concerns balanced against the government's objective of strengthening the duty to make MRP and to safeguard against practices that result in under-provision. To recognise the specific issue with respect to capital loans, we amended the proposals to provide additional flexibilities with respect to capital loans.

4. The government will issue a full response to the consultation in due course. The intent of this document is to test these proposals with the sector and stakeholders to make sure that they address the specific concerns raised but do not create additional risk to either the government's objectives or to the sector. This is particularly important given the technical nature of the changes. The evidence gathered in response will inform the government's final response.

5. This document should be read alongside **Annex A – Post consultation regulation changes** which sets out the text that would be introduced into regulations.

6. Please note that the **Statutory Guidance on Minimum Revenue Provision** *<https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678868/Statutory_guidance_on_minimum_revenue_provision.pdf>* (Statutory Guidance) will be revised to reflect the changes in regulations.

Annex A

27 Duty to make revenue provision

(1) During the financial year beginning on 1st April 2004 and every subsequent financial year, a local authority—

(a) shall charge to a revenue account a minimum amount ("minimum revenue provision") for that financial year in respect of the financing of all capital expenditure, subject to paragraphs (3) and (4), incurred by the local authority in that year or any financial year prior to that year; and

(b) may charge to a revenue account any amount in addition to the minimum revenue provision, in respect of the financing of any capital expenditure incurred by the local authority in that year or any financial year prior to that year.

(2) During the financial year beginning on 1st April 2004 and every subsequent financial year, a parish council or charter trustees may charge to a revenue account any amount in respect of the financing of capital expenditure incurred by the parish council or the charter trustees, as the case may be, in that year.

Background

7. Under Regulation 27 of the 2003 Regulations, local authorities are required to charge MRP to their revenue account in each financial year. Before 2008, the 2003 Regulations contained details of the method that local authorities were required to use when calculating MRP. This has been replaced by the current Regulation 28 of the 2003 Regulations, which gives local authorities flexibility in how they calculate MRP, providing the calculation is 'prudent'. In calculating a prudent provision, local authorities are required to have regard to the **Statutory Guidance** *<https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678868/Statutory_guidance_on_minimum_revenue_provision.pdf>* .

8. To address concerns that some authorities were not making adequate provision, the government proposed changes to the relevant regulations to strengthen compliance with the duty to make MRP. Details of the government's objective and the proposed changes are set out in the **consultation** *<https://www.gov.uk/government/consultations/changes-to-the-capital-framework-minimum-revenue-provision/consultation-on-changes-to-the-capital-framework-minimum-revenue-provision>* document. In addition, the government ran a series of roundtables as well as inviting direct engagement with councils and stakeholders to make sure that views were fully captured, and to make sure the reforms would not have unintended consequences to service delivery and financial sustainability.

Matters arising from the consultation

9. The government will respond to the consultation in full, in due course. However, a significant and recurring concern was raised by a number of authorities with respect to capital loans. In light of the risks highlighted, we have reviewed the changes to regulations and included in **Annex A** modified proposals. The original objective, set out in the consultation, of tightening the MRP duty to remove practices that result in under-provision, remains. The regulation changes have, however, been amended to provide additional flexibilities to address concerns specific to capital loans.

10. The concern set out in the sector's responses is that, under current regulations and guidance, it is common practice for authorities to not make MRP on capital loans made to other parties (provided the loan is being repaid, or is expected to be repaid). The proposed changes to the regulations, as originally drafted, would mean that MRP would be required on all capital expenditure financed by debt, including capital loans. It is an objective of the regulation changes to ensure that MRP is made on all capital expenditure made by debt, so an increase in the requirement to make MRP is not in itself sufficient for the government to consider an amendment. However, specific issues were raised with respect to capital loans that warranted a review of the proposals:

Firstly, the argument put forward is that, unlike the direct purchase of assets, the risk with capital loans is one of credit risk. Therefore, where a loan is being or will be repaid in full, it may be reasonable to not make an additional revenue charge *without increasing financial risk*. Where a loan is repaid, this does not give rise to a useable resource and so represents cash for the repayment of the authority's own borrowing.

Secondly, that capital loans are commonly used to deliver housing through companies, and the changes to regulations would make a number of these schemes unaffordable.

Thirdly, that many authorities reported that if they needed to make MRP on loans it would create significant financial pressures.

11. We have carefully considered the sector's representations. The priority objective remains to strengthen compliance with the MRP duty, however, we have drafted modified amendments with the intent of safeguarding the MRP duty while still enabling priorities of housing delivery and limiting impacts to financial sustainability.

Amended proposal

12. The substance of the previous proposals remains. That is, authorities must determine a prudent amount of MRP with respect to **all capital expenditure** financed by debt; and, **capital receipts may not be used to directly reduce what would otherwise be a prudent revenue charge** (see **Annex A paras 27(1)(a) and 28(4)**). Details on the rationale are as per the original **consultation** *<https://www.gov.uk/government/consultations/changes-to-the-capital-framework-minimum-revenue-provision/consultation-on-changes-to-the-capital-framework-minimum-revenue-provision>* document.

13. As before, this does not preclude delaying the payment of MRP until such time as the asset is operational or making the first MRP charge in the year following the expenditure (as currently permitted under proper practices set out in the **Statutory Guidance** *<https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678868/Statutory_guidance_on_minimum_revenue_provision.pdf>*). This has now been made explicit in the proposed changes to regulations (**Annex A, para 27(3)**).

14. As before, the government's intent is that **these proposals be applied prospectively** – meaning that the government does not expect any authority to have to amend any MRP charges prior to the period 2023/24 as a consequence of these amendments. Prospectively does *not mean* the changes only apply to new debt - the changes will apply to the Capital Financing Requirement (CFR) as at 1 April 2023 and to the CFR thereafter.

15. To address the concerns with respect to capital loans, the following changes have been introduced.

Authorities may opt to exclude capital loans from the requirement to make MRP

16. Where an authority had made a capital loan which is financed by debt and would otherwise require an MRP charge, an authority *may* choose to not make MRP with respect to that loan (**Annex A 27(4)).**

17. This is only permitted where the capital loan is not a commercial loan. A commercial loan is defined as one which is for capital expenditure which, if undertaken by the authority directly, would be an investment made wholly or mainly in order to generate financial return **(Annex A 27(4) and (5)).** For absence of doubt, this is intended to be substantively consistent with both the CIPFA Prudential Code's definition of investments for commercial purposes as set out in the **Prudential Code** *<https://www.cipfa.org/policy-and-guidance/publications/t/the-prudential-code-for-capital-finance-in-local-authorities-2021-edition>* ; and, HMT's definition of investment primarily for yield in the **Public Works Loan Board guidance** *<https://www.dmo.gov.uk/media/17989/pwlb-guidance-for-applicants-may-2022.pdf>* . This reflects the increased risk associated with investments primarily for return; the government has been clear that authorities should not borrow and invest primarily for profit.

4 Q1: Do you agree with the proposal that capital loans may be exempt from the need to charge MRP?

(Required)

Please select only one item

- ○ Yes
- ○ No
- ○ Unsure

(Required)

5 Q2: Does the proposed wording in Annex A sufficiently represent the policy intent as described?

(Required)

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Unsure

(Required)

Authorities must make an MRP charge no less than equal to the expected or actual loss as recognised under IFRS 9 for relevant capital loans.

18. If authorities do not have to make MRP for capital loans, there is a risk that they will not have sufficient funds to repay their own debt if the capital loan is not repaid in full. IFRS 9, as interpreted by CIPFA LASAAC, already provides a means of measuring and recognising expected and actual credit loss. By mandating that an MRP charge be made that is *no less than* the loss recognised under IFRS, this should ensure sufficient funds are set aside for the repayment of the authority's debt.

19. For any expected or actual credit loss on a capital loan, the required MRP must be made in full in the year the loss is recognised **(Annex A 28(2)).** There is no option to spread the MRP cost over future years.

20. If an authority had opted to charge MRP with respect to a capital loan *before a loss on that loan occurs* then it will have already set aside funds to mitigate this risk and it may reduce the charge with respect to the loss by any historic MRP made with respect to that loan (**Annex A 28(3)**).

6 Q3: Do you agree that authorities should make MRP equal to any loss recognised with respect to a capital loan?

(Required)

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Unsure

(Required)

7 Q4: Do you agree that using IFRS 9 as the basis for measuring the expected credit loss or impairment that must be charged as MRP is appropriate?

(Required)

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Unsure

(Required)

8 Q5: Does the proposed wording in Annex A sufficiently represent the policy intent as described?

(Required)

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Unsure

(Required)

Capital receipts which are either repayments to the authority with respect to a capital loan or the element of a lease repayment which is a capital receipt may be used to directly offset the prudent charge to revenue.

21. The changes to the regulations prevent authorities using capital receipts as a one-for-one replacement for the MRP, which should be a prudent charge to revenue (**Annex A 28(4)**). Under both the current and original proposals, authorities may still apply capital receipts to reduce their overall debt position, which would then indirectly reduce the revenue charge.

22. The new proposals introduce an exception, whereby repayments of a loan to an authority, which are otherwise capital receipts, may be used to directly offset the charge to revenue that would otherwise be made (**Annex A 28(5, 6, 7)**).

23. If an authority *is not making MRP* on its capital loans under Annex A 27(4), then this additional flexibility has no effect. As there is not MRP to offset. However, if an authority chooses to make MRP on a capital loan or is required to because the capital loan is for commercial purposes, then the effect is to remove the need to make MRP (in part or in full) provided the loan is being repaid to the authority.

24. Where this is applied, an authority must still make MRP in years where no capital receipt is received, and cannot choose to not make MRP with respect to a capital loan on the *expectation* of a repayment in a future financial year. This is because the new flexibility only allows MRP to be offset by a capital receipt in the year the receipt is received (**Annex A 27(4 and 5)**). However, under proper practices set out in the **MRP statutory guidance** *<https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678868/Statutory_guidance_on_minimum_revenue_provision.pdf>* , it is allowable for an authority to take into account if it has *overprovided* MRP in prior years and reduce a future MRP charge to the extent to which prudent provision has already been made.

25. This exception also applies to where an authority is the lessor in a lease arrangement which, under proper account practices, is treated as the authority having (in substance) disposed of an asset and made a loan to the lessee (**Annex A 28(6)**). Where an authority has borrowed to purchase an asset, which it has then leased out under such an arrangement, under the original proposals, the authority would have needed to charge MRP because the changes clearly state MRP is required on *all* capital expenditure financed by debt. As the element of the lease payment that is a capital receipt is effectively a loan repayment, the same exception applies as for all capital loans. The capital receipt may be used to directly offset the charge to revenue. In effect, an authority that is a lessor will not be required to make a charge to revenue *provided the lease repayments are being made*.

9 Q6: Do you agree that authorities should be able to use capital receipts that are loan repayments (including the capital receipt element of a lease payment) to directly reduce the prudent charge to revenue?

(Required)

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Unsure

(Required)

10 Q7: Does the proposed wording in Annex A sufficiently represent the policy intent as described?

(Required)

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Unsure

(Required)

Views on impacts to authorities and timing of introduction

The government would like to understand the impact to authorities under the amended proposal, and also seek views on the timing of the introduction of the proposed regulation changes.

11 Q8: If you identified risks to service delivery, including the delivery of housing or other local priorities, as a result of the original proposal, does this amended proposal sufficiently mitigate or remove those risks?

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Partially

12 Q9: If you identified financial pressures as a result of the original proposal, does this amended proposal sufficiently mitigate or remove those risks?

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Partially

13 Q10: Assume that this amended proposal becomes effective from April 2023. What, if any, would be the increase to your MRP charge in 2023/24 as a result of these changes?

Please select only one item

- ◯ Yes
- ◯ No
- ◯ Partially

14 Q11: The plan is to introduce these changes from April 2023. Please indicate if you agree with this timetable. If you do not agree, please set out the reasons.

Please select only one item

- ◯ Yes
- ◯ No

15 Q12: Please add any further comment on the proposals.